



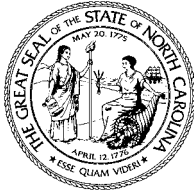
STATE OF NORTH CAROLINA

**FISCAL CONTROL AUDIT REPORT ON THE
DEPARTMENT OF CULTURAL RESOURCES
RALEIGH, NORTH CAROLINA**

**OFFICE OF THE STATE AUDITOR
LESLIE W. MERRITT, JR., CPA, CFP
STATE AUDITOR**

**FISCAL CONTROL AUDIT REPORT ON THE
DEPARTMENT OF CULTURAL RESOURCES
RALEIGH, NORTH CAROLINA**

LISBETH C. EVANS, SECRETARY



STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Ms. Lisbeth C. Evans, Secretary
Department of Cultural Resources

This report presents the results of our fiscal control audit of the Department of Cultural Resources. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report. We also noted certain matters that we reported to management of the Department of Cultural Resources in a separate letter dated May 25, 2005.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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BACKGROUND INFORMATION

The Department of Cultural Resources was formed in 1971 for the purpose of enhancing resources, services and programs involving the arts, as well as the historical and cultural aspects of life in North Carolina. The Department's objectives include preservation of libraries and historical records, sites and property and promoting an appreciation of art and music.

The Department is comprised of the Office of Archives and History and the Office of Arts and Libraries. The Office of Archives and History includes three divisions: the Division of State Museums, the Division of State Historic Sites and the Division of Historical Resources. The Office of Arts and Libraries includes four divisions: the North Carolina Museum of Art, the North Carolina Arts Council, the North Carolina Symphony and the State Library of North Carolina.

In the fiscal year ended June 30, 2004, the Department spent approximately \$65 million in the general fund and \$4 million in its special revenue funds. Approximately one-half of the expenditures were for personnel costs and over one-third of the expenditures were for grants, state aid and subsidies. The primary sources of funds for the Department were general fund appropriations of approximately \$56 million and approximately \$6 million in federal funds.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes* and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at the Department of Cultural Resources.

The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for issuing an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

SCOPE

Our audit generally covered the period July 1, 2004, through December 31, 2004, but also included certain control activities that were required at or near the conclusion of the year ended June 30, 2004. The audit included selected internal controls in the following organizational units:

Administrative Services – Among other duties, this organizational unit is responsible for the general accounting functions of the Department. The unit accounts for transactions and issues financial reports covering all Department operations.

North Carolina Arts Council – This organizational unit works to support excellence in the arts and to provide opportunities for North Carolina citizens to experience the arts, primarily through the awarding of grants of state and federal funds to assist in the production of arts experiences.

During our audit, we considered internal control related to the following accounts and control objectives:

Capital Assets – These are assets acquired with an initial cost of \$5,000 or more and an estimated useful life of more than one year. At June 30, 2004, the Department reported capital assets with a historical cost of over \$100 million. We examined internal control designed to ensure that the Department properly accounts for and reports these assets.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

Inventories – This account includes general supplies as well as items purchased for resale. At June 30, 2004, the Department reported over \$1 million in total inventories; however, our audit focused only on the general supplies inventory, which totaled approximately \$397 thousand. We examined internal control designed to ensure that the Department properly accounts for and reports inventory.

Grants, State Aid and Subsidies – Our audit focused on grants paid to nonprofit organizations by Administrative Services and the Arts Council. The Department was appropriated approximately \$10 million for grants to nonprofit organizations selected by legislative leaders and another \$2 million for grantees specifically named in legislation. In addition, the Department reported grant expenditures made by the Arts Council during our audit period of approximately \$3 million. We examined the internal control designed to ensure that the Department properly accounted for and reported the transactions and complied with State law governing grants to nonprofit organizations. Among other things, the law requires state agencies to report grants made in the previous year to the Office of the State Auditor and to monitor grants to ensure that moneys are used by recipients for the intended purpose.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and/or performed direct tests of the accounts and transactions as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records and examining documentation supporting recorded transactions and balances.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report. We also noted certain other matters that we have reported to management in a separate letter dated May 25, 2005.

AUDIT FINDINGS AND RECOMMENDATIONS

1. REQUIRED PROCEDURES FOR GRANTS TO NONPROFIT ORGANIZATIONS NOT FOLLOWED

The Department did not monitor most grants made to nonprofit organizations and did not consistently obtain required documents from grant recipients. As a result, there is an increased risk that funds were spent for improper purposes.

For the fiscal year ending June 30, 2005, the Department was appropriated approximately \$10 million for grants to nonprofit organizations selected by legislative leaders. The Department has not monitored the use of the grants through site visits or other means to prevent misuse of state funds. In response to our inquiries, the Department developed a standard letter to be sent to grant recipients requesting information about the use of grant proceeds.

When our audit began, the Department had also not prepared documents describing standards of compliance and suggested audit procedures sufficient to give adequate direction to independent auditors performing audits of these grants. This “compliance supplement” was prepared by the Department before our audit was completed.

Also for the fiscal year ending June 30, 2005, the Department was appropriated over \$2 million for grants to nonprofit organizations specifically named in legislation, primarily the North Carolina Symphony. For these grants, the Department did not consistently obtain required documents such as the charter, by-laws, list of board members, conflict of interest policy and tax-exemption letters prior to making disbursements to the organizations. In many instances, the monitoring procedures described above were also not performed.

State agency responsibilities regarding grants to nonprofit organizations are described in *North Carolina General Statute 143-6.1*. Included in the law are the requirements that agencies provide for adequate oversight and monitoring of grant funds and develop compliance supplements for the recipients’ auditors. The North Carolina Office of State Budget and Management has directed agencies to follow specific procedures for the disbursement of “special appropriations” like those administered by the Department. These procedures require agencies to obtain the documents cited above prior to disbursing grants.

Recommendation: The Department should implement procedures to provide reasonable assurance that recipients use grant funds for intended purposes. The nature and extent of the necessary procedures will depend on factors such as the complexity of the grant restrictions and the degree to which the grants are expected to be audited by the recipient’s auditors.

Department’s Response: The Department will revise procedures to ensure compliance with statutory and Office of State Budget and Management rules and requirements. Internal control will be enhanced to give management assurances that these procedures are effective.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

2. CAPITAL ASSETS NOT PROPERLY CLASSIFIED

The Department did not properly classify capital asset and inventory items in its financial records and reports. As a result, amounts reported in the State's *Comprehensive Annual Financial Report* were misstated.

We found capital assets recorded as equipment that would have been more appropriately reported in other accounts:

- A transfer of assets from another state agency that included land, with an approximate original cost of \$470,000; and buildings, with an approximate original cost of \$2.8 million, should have been recorded as land and buildings;
- Two historic replicas, with an approximate original cost of \$970,000, should have been recorded as art, literature and artifacts;
- Several tractors, with an approximate original cost of \$200,000, should have been recorded as motor vehicles and motorized equipment.

We also noted a number of items that were reported as supplies inventory that should have been accounted for as capital assets. We identified inventory items with an approximate cost of \$96,000 that should have been reported as capital assets. One of these items, with a cost of \$7,537, was reported as both an inventory item and a capital asset.

The Office of the State Controller publishes guidelines to be followed when classifying assets.

Recommendation: The Department should carefully consider the Office of the State Controllers classification guidelines when recording capital assets and inventory items. The Department should also review the listing of assets previously recorded to correct misclassified amounts.

Department's Response: Errors in classification have been corrected. Classification guidelines established by the Office of the State Controller will be reviewed periodically and the current year fixed assets listings will be compared annually with the prior year listing to identify significant variances and possible misclassifications.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press and the general public upon request.

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Director, Fiscal Research Division

June 29, 2005

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2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

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Telephone: 919/807-7500

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